United States Senate Committee on Finance

Hearing: America's Affordable Housing Crisis: Challenges and Solutions

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Statement of:

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Reform of the Low-Income Housing Tax Credit Program

How does the Low-Income Housing Tax Credit (LIHTC) program work?

Tax credit authority is allocated annually from the federal government to each state which, through its Housing Finance Agency (HFA), awards the tax credits to development proposals. The annual allocations totaled to about $7.6 billion in fiscal year 2015 (Gramlich, 2015).

Each developer sells the tax credits to investors who join into the ownership of the development with the proceeds from the sale of the tax credits used to pay for a portion of the development costs. In exchange for receiving the tax credits, developers agree to limit the rents on the housing units to levels affordable to low-income households and to maintain low-income occupancy in the tax credit supported units for a period of at least 15 years.

How as the program performed?

The program began in 1987 and produced about 2.6 million low-income units since its inception. Annually, the program typically produces about 90,000 units in 1,400 projects.

Who is served by the program?

The income ceilings for participation in the LIHTC program vary with the metropolitan area or with the county if the location is outside of a metropolitan area. The maximum income for a household occupying a tax credit unit is a set percentage of the Area Median family Income (AMI). The LIHTC program limits the highest income of households who reside in LIHTC units at either 50 percent or 60 percent of the AMI, depending upon developer selection and state HFA preferences. In 2015, the national median family income was $66,011. Thus, the program tends to serve households with incomes below either $33,000 or $40,000.

The U.S. Department of Housing and Urban Development (HUD) defines low-income somewhat differently than does the LIHTC program, but the HUD definitions are helpful for understanding which households are served by the various low-income housing programs. HUD defines any household as low-income if its income is below 80 percent of the AMI. HUD further defines two subsets of the low-income households as: 1: Very low-income, those with income between 30 and 50 percent of AMI; and 2: Extremely low-income, those with income below 30 percent of AMI. These distinctions are important because markets very widely in terms of which category of low-income renter households suffer from shortages of units.

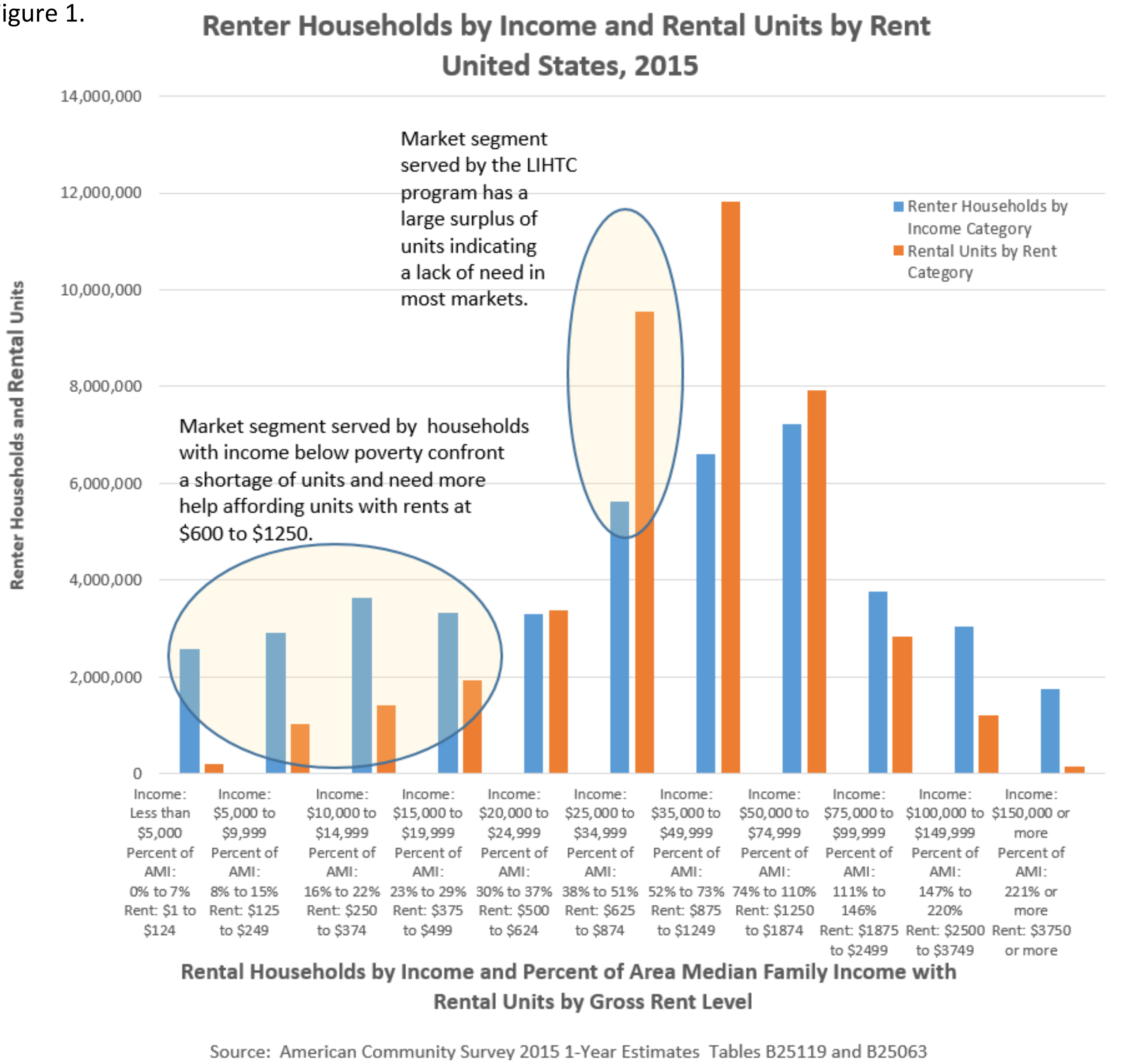
O'Regan and Horn (2013) find that about 45 percent of LIHTC households have incomes below 30 percent of AMI, and 55 percent have incomes between the 30 percent and the 60 percent ceiling level. Low-income households with income in the upper tier, between 60 and 80 percent of AMI, are not permitted into the units as their income is too high. Households with incomes in the lowest tier, below 30 percent of AMI, can usually afford the rents charged in LIHTC developments only if they have additional subsidy through the Housing Choice Voucher (HCV) program. Williamson (2011) found that about 10 percent of Florida LIHTC households had vouchers. Thus, most non-voucher LIHTC households tend to have income at the middle tier of the low-income levels or about $20,000 to $40,000. For comparison, public housing and the HCV programs serve the poorest tier of the low-income renter population, households with an average income of about $14,000 (Calculated from HUD data for 2015).

Does the LIHTC program produce units in a price range where there is a need?

If the LIHTC program tends to serve households with incomes in range of $20,000 to $40,000, does this income segment suffer from a shortage of rental units priced so that they can afford the units?

Figure 1 below divides the rental housing stock of the nation into market segments. Renter households are divided into income categories from the American Community Survey, 2015. Rental units are divided into categories based on gross rents (rents plus utilities). These rent categories correspond to the renter income categories assuming that these households spend 30 percent of income on housing, which is about the median level of spending for renters nationwide.

Figure 1.



For example, a household with income of $25,000 per year can afford a unit with rent at $625, and a household with and income of $35,000 can afford rent of $875. Thus, the rental units with gross rents from $625 to $875 can be compared to the numbers of households with incomes from $25,000 to $35,000. In rent categories where the number of units exceeds the number of renter households, a surplus exists, and where households exceed units, a shortage exists.

The segment of the rental housing market served by the LIHTC program has a large surplus of units. There are many more units renting in the price range of $625 to $875 per month than there are households with incomes in the range of $25,000 to $35,000, the households who can afford units in this price range. This is the market segment where the LIHTC is adding units.

It is a very different story in the rental housing market segment served by the HCV program. This program assists households with incomes below $20,000. Households in this market segment can only afford rental units with much lower rents, averaging about $350 per month. All the market segments with rents below $500 have fewer units than there are households.

Thus, the LIHTC program is adding units to a market segment with a large surplus of units indicating a lack of need in most markets.

Does the LIHTC program locate units in tracts with a shortage of units?

What is true for the nation as a whole is not necessarily true for individual markets. While the nation may have a surplus of units in the market segment with rents from $625 to $875, many individual markets may have a shortage. The LIHTC could be the right form of governmental intervention to resolve this problem if it is targeting those locations with shortages.

Table 1 indicates that LIHTC units are being located in census tracts that do not have a shortage of rental units in the price range serving low-income renter households. Table 1 categorizes the 73,000 census tracts in the nation by comparing the number of renter households with income between $25,000 to $35,000 to the number of rental units with rents between $625 and $875. If the LIHTC program is working well, it should be locating units in tracts with a shortage of units in this price range compared to the number of households in the income range.

Table 1. **Low-Income Housing Tax Credit Units by Tract Rental Market Need**

Number of rental units with rents $625 to $875 minus renter households with income of $25,000 to $35,000

Rental market need category	*Tracts (Percent)*	*LIHTC Units (Percent)*
Shortage 200 or more units	231 (0.3%)	18,013 (0.7%)
Shortage 50 to 199 units	5,102 (7.0%)	190,868 (7.9%)
Balanced -49 to +49 units	39,033 (53.4%)	687,597 (28.3%)
Surplus 50 to 199 units	**21,966 (30.1%)**	**929,850 (28.3%)**
Surplus 200 or more units	**6,724 (9.2%)**	**603,944 (24.9%)**
Total	73,056 (100.0%)	2,430,272 (100.0%),

Source: American Community Survey, 2015, 1-year estimates; HUD LIHTC Database, 2017.

Fewer than 9 percent of LIHTC units are located where there is a shortage. This is not entirely surprising as fewer than 8 percent of all the tracts in the nation have a shortage suggesting that the need for units in the price range served by the LIHTC program is small. Over one-half of all LIHTC units are in tracts with a surplus of more than 50 units. One-fourth of all LIHTC units are in tracts with a surplus of 200 or more units.

Does the LIHTC add new units to tight markets and rehabilitate existing units in soft markets?

It would be expected that the program would add new construction units to tight markets, those with low vacancy rates, and rehabilitate existing units in soft markets, those with high vacancy rates.

Table 2. **LIHTC Units by Construction Type in Tracts by Rental Vacancy Rate**

	LIHTC Units		
Rental Vacancy Rate	New Construction	Units Rehabilitation	Type Known
Tight 0 to 4.9%	440,692	305,227	745,919
	59%	41%	100%
Normal 5.0 to 6.9%	155,153	113,323	268,476
	58%	42%	100%
Soft 7.0% to 9.9%	207,558	139,446	347,004
	60%	40%	100%
Very soft 10%+	357,266	232,960	590,226
	61%	39%	100%
Total	1,160,669	790,956	1,951,625
	59%	41%	100%

Source: American Community Survey, 2015, 1-year estimates; HUD LIHTC Database, 2017.

The LIHTC program favors new construction over rehabilitation in all markets. Nine percent credits are awarded against new construction costs, and four percent credits are awarded against rehabilitation costs, independent of market conditions.

Developers have responded by developing 47 percent more new construction units than rehabilitation units. There is a strong tendency for the program to produce new construction units over rehabilitation units without regard to the rental vacancy rate.

Does the LIHTC program support mixed-income housing?

Research demonstrates that projects wholly populated by the poor are not good for the households, the developments or the surrounding neighborhoods (Smith 2002). Mixed-income housing is a more beneficial format for everyone involved (Kleit 2005).

The LIHTC program does not provide any incentives to developers to generate mixed-income housing. Rather, the program sets minimums, rather than maximums, on the percentages of households with incomes below 50 percent and 60 percent of AMI. As a result, 76 percent of all LIHTC developments are occupied entirely by low-income households. Fewer than 3 percent are configured with market-rate units comprising more than one-half of all units.

Conclusions and recommendations

It can be concluded that the LIHTC program is:

- Serving a segment of renters with a surplus of units and not serving the lowest-income segment with a shortage of units.
- Adding units to neighborhoods with a surplus of units and failing to add units where there are shortages.
- Favoring new construction over rehabilitation independent of market condition.
- Not promoting mixed-income housing.

It is time to rethink how the LIHTC program works. Four changes are recommended:

More rigorous market analysis: State Housing Finance Agencies should have to justify each LIHTC allocation by demonstrating a market need. Each HFA should have to show that both neighborhood and metropolitan vacancy rates justify production subsidies. The HFA should have to find that vacancy rates are low and that a shortage of units exists at the price point to be served by the proposed LIHTC development. There is little value in adding units to a market that has a high rental vacancy rate or in adding units to a market segment that is saturated.

Exchange tax credit authority for voucher authority: Currently, housing authorities can convert up to 20 percent of tenant-based voucher contract authority into project-based voucher authority. HFAs should be permitted the same latitude to convert project-based LIHTC funding into vouchers. These vouchers could be tenant-based vouchers, permitting extremely low-income households to rent apartments in the market if market conditions suggest this to be the preferred approach. These vouchers could also be project-based vouchers that could be layered on top of LIHTC subsidy to serve households who could not otherwise afford the tax credit units. These vouchers would help the LIHTC program both serve households with extremely low income as well as permit these households to pay a rent based on their incomes, rather than a flat rent now used in the LIHTC program. This approach prevents a high housing cost hardship among these households.

Favor Rehabilitation over New Construction: the LIHTC program should be modified so that it favors the appropriate type of development for each market. The higher 9 percent credits should be given for rehabilitation and the lower 4 percent credits should be given to new construction developments. The higher 9 percent credits would only be available to new construction units if the market is truly tight (the rental vacancy rate is very low) or the new units are replacing severely deteriorated units.

Favor Mixed-Income Development: The LIHTC should mandate mixed-income occupancy in most developments. A majority of the units in each tax credit supported development should be set-aside for market-rate occupancy. A development that is configured with a majority of units for low-income occupancy should be permitted only in a highly distressed area where mixed-income housing is not feasible and the tax credit development contributes to a community revitalization strategy.

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